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No. 20554

United States
Court of Appeals
for the Ninth Circuit

JOEL C. HERTSCHE, JR., EXECUTOR OF THE ES-
TATE OF JOEL C. HERTSCHE, DECEASED, AND JOEL
C. HERTSCHE, JR., TRANSFEREE OF THE ASSETS
OF THE ESTATE OF JOEL C. HERTSCHE, DECEASED

Appellants,

v.

UNITED STATES OF AMERICA,

Appellee

*On Appeal From the Judgment of the United States
District Court for the District of Oregon*

BRIEF FOR THE APPELLEE

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BRIEF FOR THE APPELLEE

OPINION BELOW

The opinion of the District Court (R. 36-40) is reported at 244 F. Supp. 347.

JURISDICTION

This appeal involves federal estate taxes. The date of death was March 25, 1960. The taxes in dispute were paid as follows; \$268,261.39 on June 26, 1961, and \$8,810.80 on October 10, 1963. (R. 2-3). Claim

for refund in the amount of \$9,012.93 was filed on January 15, 1964, and was rejected on June 16, 1964. (R. 4.). Within the time provided by Section 6532 of the Internal Revenue Code of 1954, on July 2, 1964, the taxpayer brought this action in the District Court for recovery of the taxes paid. (R. 54.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The judgment of the District Court was entered on July 26, 1965. (R. 46.) Within sixty days thereafter, on September 23, 1965, a notice of appeal was filed. (R. 47.) Jurisdiction is conferred on this Court by 28 U.S., Section 1291.

QUESTIONS PRESENTED

Whether the District Court correctly held that the proper date for determining the value of certain stock for inclusion in decedents' gross estate was the date of the court order directing distribution of the stock.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1954:

SEC. 2032. ALTERNATE VALUATION.

(a) *General*.—The value of the gross estate may be determined, if the executor so elects, by valuing all the property included in the gross estate as follows:

(1) In the case of property distributed, sold, exchanged, or otherwise disposed of, within 1 year after the decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition.

* * * *

(26 U.S.C. 1958 ed., Sec. 2032.)

Treasury Regulations on Estate Tax (1954 Code):

§ 20.2032-1 *Alternate valuation.*

(a) *In general.* In general, section 2032 provides for the valuation of a decedent's gross estate at a date other than the date of the decedent's death. More specifically, if an executor elects the alternate valuation method under section 2032, the property included in the decedent's gross estate on the date of his death is valued as of whichever of the following dates is applicable:

(1) Any property distributed, sold, exchanged, or otherwise disposed of within one year after the decedent's death is valued as of the date on which it is first distributed, sold, exchanged, or otherwise disposed of;

* * * *

(c) *Meaning of "distributed, sold, exchanged, or otherwise disposed of".* (1) The phrase "distributed sold, exchanged, or otherwise disposed of" comprehends all possible ways by which property ceases to form a part of the gross estate. For example, money on hand at the date of the decedent's death which is thereafter used in the payment of funeral expenses, or which is thereafter invested, falls within the term "otherwise disposed of." The term also includes the surrender of a stock certificate for corporate assets in complete or partial liquidation of a

corporation pursuant to section 331. The term does not, however, extend to transactions which are mere changes in form. Thus, it does not include a transfer of assets to a corporation in exchange for its stock in a transaction with respect to which no gain or loss would be recognizable for income tax purposes under section 351. Nor does it include an exchange of stock or securities in a corporation for stock or securities in the same corporation or another corporation in a transaction, such as a merger, recapitalization, reorganization or other transaction described in section 368 (a) or 355, with respect to which no gain or loss is recognizable for income tax purposes under section 354 or 355.

(2) Property may be "distributed" either by the executor, or by a trustee of property included in the gross estate under sections 2035 through 2038, or section 2041. Property is considered as "distributed" upon the first to occur of the following:

(i) The entry of an order or decree of distribution, if the order or decree subsequently becomes final;

(ii) The segregation or separation of the property from the estate or trust so that it becomes unqualifiedly subject to the demand or disposition of the distributee; or

(iii) The actual paying over or delivery of the property to the distributee.

* * * *

(26 C.F.R., Sec. 20.2032-1.)

STATEMENT

The material facts, which were stipulated by the parties and are set forth in the pretrial order entered by the District Court (R. 1-6.) are as follows:

Joel C. Hertsche died testate in Oregon on March 25, 1960. At the time of his death decedent was the owner of 7,400 shares of National Lead Company common stock. (R. 2.)

On October 14, 1960, the Oregon probate court entered an order authorizing and directing the executor to distribute, among other bequests, 5,000 shares of National Lead Company stock to the persons entitled to receive them. (R. 2-3, 29.) On October 25, 1960, the executor distributed the 5,000 shares of National Lead stock to the residuary legatees by transfer and physical delivery. (R. 3.)

The stock was valued for estate tax purposes in the estate tax return at \$79.6875 per share, which was the mean of the high and low selling prices on October 25, 1960. However, upon audit a deficiency in the amount of \$25,312.50 was determined by the Commissioner, based on a valuation of the National Lead Company stock as of October 14, 1960, the date of the order of distribution. (R-3.)

The District Court found that the correct date for valuation of the stock was October 14, 1960, the date of the court order of distribution, as contended by the Government. (R. 36-40.)

SUMMARY OF ARGUMENT

Section 2032 of the Internal Revenue Code of 1954 provides in part that an executor may elect to value the assets of a decedent's estate for estate tax purposes as of "the date of distribution, sale, exchange, or other disposition" if such event occurs prior to the first anniversary of the decedent's death. The Treasury Regulations interpret distribution as meaning a court order or decree of distribution if such order precedes the actual delivery of the property to the beneficiary.

In this case there was a court order authorizing and directing partial distribution of an estate, including 5,000 shares of a certain common stock. However, the executor did not actually deliver the stock to the beneficiaries until eleven days after the court order. The executor, contending that the above-mentioned regulation is invalid, valued the stock as of the date of the actual delivery, but the District Court correctly upheld the validity of the regulation and found that the value should be as of the date of the order of distribution.

The meaning of the word "distribution" as used in Section 2032 must be determined by an analysis of its use in regard to decedents' estates and the purpose of Section 2032, rather than as an isolated word or its connotation in income tax situations. It is the general rule that an executor does not actually turn over estate property to beneficiaries without a court order or decree of distribution. Furthermore, it is this court order which, in most instances, vests title in, or establishes the rights of, the beneficiaries entitled to receive the property. Therefore, distribution as used in Section 2032 could mean the order of distribution or the actual delivery. In order to clarify this and create uniformity in the application of the provision, the regulation was enacted.

It is well settled that a long standing regulation may not be declared invalid except for weighty reasons, since it has the force and effect of law. This is particularly true when there has been continuous reenactment of the Code section and also when the regulation is a contemporaneous construction of the Code.

Furthermore, the regulation in question is a reasonable interpretation of the word distribution as used in Section 2032 and is in complete harmony with that

provision of the Code. The regulation is concerned with fixing a definite date for purposes of valuation which may be uniformly applied. In such a situation it is not necessary for the valuation date to coincide with the date the beneficiary reduces the property to possession. The regulation does not always benefit either the Government or the taxpayer, and is meant merely to avoid the uncertainty and confusion which would result from the various interpretations of the word distribution.

ARGUMENT

THE DISTRICT COURT CORRECTLY HELD THAT THE PROPER DATE FOR DETERMINING THE VALUE OF CERTAIN STOCK FOR INCLUSION IN DECEDENT'S GROSS ESTATE WAS THE DATE OF THE COURT ORDER DIRECTING DISTRIBUTION OF THE STOCK.

Prior to 1935 the property of a decedent was valued as of the date of death for the purpose of computing the estate tax. But in 1935 the law was changed to allow alternative valuations to be made one year from the date of death or, as Section 2032, *supra*, now states:

In the case of property distributed, sold, exchanged, or otherwise disposed of, within 1 year after the decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition.

Shortly after this new provision was enacted in 1935, Treasury Regulations interpreting this section were issued. Treasury Regulations 80, Art. 13 1/2 (T.D. 4699, XV-2 Cum. Bull. 293 (1936)). That regulation was the predecessor of Treasury Regulations on Estate Tax, Section 20.2032-1(c) (2), *supra*, which provides that —

Property is considered as “distributed” upon the first to occur of the following:

(i) The entry of an order or decree of distribution, if the order or decree subsequently becomes final;

(ii) The segregation or separation of the property from the estate or trust so that it becomes unqualifiedly subject to the demand or disposition of the distributee; or

(iii) The actual paying over or delivery of the property to the distributee.

In this case Joel Hertsche died on March 25, 1960, and, at that time he owned 7,400 shares of National Lead Company stock. On October 14, 1960, or within one year of the date of death, the Oregon probate court “authorized and directed” (R. 29) a partial distribution of the estate which included 5,000 shares of National Lead stock. On October 25, 1960, the executor actually delivered the 5,000 shares of stock to the heirs entitled to it. The executor valued the stock as of October 25, the date of the actual delivery, but the

Commissioner in accordance with the above regulation, determined that the stock should be valued as of October 14, the date of the order of distribution. The District Court correctly found that the regulation in question was valid and that it was therefore proper to value the stock as of the date of the order of distribution.

Taxpayer argues on this appeal that distribution as used in Section 2032 of the Internal Revenue Code means *only* "actual delivery" and therefore the regulation which states that distribution can occur at any other time is invalid. But, there is no merit to this contention. The meaning of the word distribution as used in Section 2032 is not clear, and the interpretative regulation, on which the Commissioner relied, which has been in effect for almost thirty years, is valid. Therefore the proper date for the valuation of the stock was October 14, 1960.

In *Towne v. Eisner*, 245 U.S. 418 (1918), Mr. Justice Holmes said (p. 425):

A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.

With this in mind, we examine the word distribution as used in Section 2032 in order to determine its meaning. Section 2032 deals with the valuation of property for the purpose of computing the gross taxable estate. The dates relate either to the date of death of the decedent, or to the time prior to one year after death at which the property is separated from the estate. All of the acts enumerated in Section 2032(a) (1) apparently deal with the time at which the property is taken out of the general estate, such as by distribution, sale, exchange or other disposition. Therefore, distribution must be taken in this context and not, as taxpayer urges, in the context of various income tax sections of the Code.

There is no question that in almost all instances, actual physical delivery of estate assets is preceded by a court order or decree of distribution. In fact, Oregon follows the general rule that an executor or administrator who turns over estate property to anyone without a court order does so at his own risk, even if the persons are entitled to the property. See, *In re Freitag's Estate*, 165 Ore. 427, 434, 107 P. 2d 978, 980 (1940); *Weider v. Osborn*, 20 Ore. 307, 313, 25 Pac. 715 (1891); *In re Greer's Will*, 208 N.Y.S. 2d 243 (1960); *Barrett v. Macdonald*, 264 Minn. 560, 121 N.W. 2d 165 (1963); *Quevedo v. Union Pac. R. Co.*,

115 F. Supp. 25, 28 (N.D. Ill., 1953); *Adamo Estate*, 82 Pa. D. & C. 222 (1952). Therefore, it is clear that a court order will, in all but the unusual case, precede any physical distribution of property. Furthermore, it is also generally held that the order of distribution establishes the rights of the persons who are to receive the property, or vests title in them, and therefore separates the property from the estate. See, *Lang v. Lang*, 17 Utah 2d 10, 403 P. 2d 655 (1965); *Smith v. McLaren*, 58 Wash. 2d 907, 365 P. 2d 331 (1961); *Estate of Doescher*, 31 Cal. Rptr. 346, 217 Cal. App. 2d 104 (1963); *Oberlander v. Eddington*, 391 P. 2d 889 (Okla., 1964). In Oregon, as in many other jurisdictions, it is clear that the interest of a creditor, heir or devisee of an estate is subject to garnishment in the hands of the executor after an order for distribution.¹ *Thorsen v. Hopper*, 50 Ore. 497, 93 Pac. 361 (1908); *Harrington v. La Rocque*, 13 Ore. 344, 10 Pac. 498 (1886). See also Annotation, 59 A.L.R. 777.

As a result, it can be seen that the word "distribution" as used in the context of Section 2032, could have various meanings. In most instances it would mean the order or decree of distribution, since that is

¹Although this is now taken care of by statute, Oregon Revised Statutes (Chapters Replaced 1963-1964), Section 29.175, the cases indicate that this was the law prior to the statutory provision.

the time at which the person entitled to the property receives his rights to the property or gets his title, or in effect, the property is separated from the estate, so that the actual physical transfer of the property has no significance. In these cases to have the value of the property for estate tax purposes depend on when the actual delivery of the property took place would be completely inconsistent with the language and purpose of Section 2032. The need for an interpretative regulation which clarifies the meaning of distribution as used in Section 2032 and provides for uniform application in this situation is manifest.²

Once it is determined that the word distributed is, in the context of Section 2032, ambiguous enough to allow interpretation, the only remaining question is the validity of Treasury Regulations on Estate Tax, Section 20.2032-1(c)(2)(i), which states that distribution may take place upon "The entry of an order or decree of distribution, if the order or decree subsequently becomes final." If this regulation is valid then the District Court was correct in holding that the stock

²It might also be noted that even in the income tax sections of the Code distribution does not always mean actual delivery. For instance, a dividend may be "distributed" from a corporation to a shareholder even though there was no actual transfer of funds from the corporation. See, *Clark v. Commissioner*, 266 F. 2d 698 (C.A. 9th, 1959).

must be valued as of October 14, 1960, the date of the order of distribution.

It is well settled that the Commissioner has the authority to issue Regulations interpreting the Internal Revenue Code, and that these Regulations will not be overruled by the courts except for weighty reasons. See e.g., *Commissioner v. South Texas Co.*, 333 U.S. 496 (1948). There are several theories upon which the validity and effect of a regulation is based. One is the theory of legislative re-enactment, most recently restated by the Supreme Court in *Commissioner v. Noel Estate*, 380 U.S. 678 (1965), which said (p. 682): "We have held in many cases that such a long-standing administrative interpretation, applying to a substantially reenacted statute, is deemed to have received congressional approval and has the effect of law." See also *Helvering v. Reynolds Co.*, 306 U.S. 110 (1939); *Cammarano v. United States*, 358 U.S. 498 (1959); *Helvering v. Winmill*, 305 U.S. 79 (1938). This rationale, i.e., that Congress is aware of the Treasury Regulations and gives its approval by reenacting the statute without changes, could be applied here since the regulation in question was originally issued in 1936³, and the Code section has been

³Treasury Regulations 80, Article 13 1/2.

reenacted several times without substantial change, despite the major revisions of other sections of the Code. Another theory which could be applied is that of contemporaneous construction, since the original regulation was issued shortly after the Code section was added. Here the reasoning is that Regulations issued contemporaneously with the enactment of a statute will be presumed to represent the general understanding of the meaning of the statutes and of legislative intent. *Commissioner v. South Texas Co.*, 333 U.S. 496 (1947); *Fawcus Machine Co. v. United States*, 282 U.S. 375 (1931).

Furthermore, it can be demonstrated that the definition of distribution in the Regulations is in complete harmony with the statute rather than an "unwarranted extension of the statute" as contended by taxpayer. (Br. 7.) An examination of the history of Section 2032 reveals that Congress wanted to amend the old rule that property must always be valued at the date of the decedent's death for estate tax purposes.⁴ While the purpose of this was to lessen the burden of the estate tax during a period when the value of property was declining, there is no indication that Con-

⁴See, H. Rep. No. 1681, 74th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 642); H. Conference Rep. No. 1885, 74th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 660); S. Rep. No. 1240, 74th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 651).

gress thought it was eliminating all inequities in every situation where there was a decline in the value of the assets of the estate. For instance, the latest possible date for the alternate valuation is one year from the date of death, but it is entirely possible that some estates which cannot be distributed within one year will continue to decline in value after the one year. In such a situation the beneficiaries would get no further relief, and would therefore receive no tax benefit from the shrinkage in the estate after the first year. Furthermore, two of the alternative dates, the date of death and one year after the date of death, are fixed with definite certainty, and if distribution were not defined there would be doubt and uncertainty as to exactly what date is meant by that word. Also, if distribution means only physical delivery, as taxpayer contends, then an executor would have great difficulty in controlling the estate. For instance, suppose a beneficiary refuses to accept delivery of property after the order of distribution, or for some other reason actual delivery of the property is not made. In such a situation the estate tax could not be determined, and, furthermore, by holding off on accepting his legacy one beneficiary could increase the estate tax and cause the others to bear the burden. It does not appear that a regulation which eliminates all these undesir-

able possibilities and fixes definite dates for the valuation of the property when it is taken out of the estate within one year of the decedent's death is out of harmony with the statute.⁵

It might be noted that the regulation in question is not one which will always benefit the Government, since the property may go up in value between the order of distribution and the actual delivery". In fact, if that had been the situation in the instant case we wonder if taxpayer would be here contending that the regulation is clearly invalid. Obviously the purpose of the regulation is to fix with a degree of certainty the date of valuation, and to do so in the context of the purpose of Section 2032. The dates on which distri-

⁵Taxpayer cites (Br. 10-11) the example given in H. Conference Rep. No. 1885, 74th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 660) as indicating that Congress intended "distribution" to mean actual delivery. But, in the example used in the committee report there is no mention of a court order or decree of distribution, which, as we have pointed out above, generally precedes any physical delivery. Therefore, this example shows either that Congress did not think about the particular problem of a court order when writing this example, or that the example refers to the unusual situation in which there is a physical delivery prior to or without a court order, in which case we agree that the value should be at the date of the physical delivery. See Section 20.2032-1 (c) (2) (iii).

⁶Furthermore, even when the value of the property does decline slightly before there is actual delivery, as in the instant case, this may not necessarily be detrimental to the legatee. Although a higher estate tax may be paid, the basis of the property in the hands of the legatee will also be higher (Section 1014, Internal Revenue Code of 1954), and this will be advantageous when he disposes of the property.

bution is effected according to the regulation are those on which the property is separated from the estate. In the instant case the court order directed distribution of the stock to certain devisees, which was within the authority of the court.⁷ Although taxpayer asserts that the property was still in the estate and subject to its debts even after the court order, no authority for this is given and no case on point could be found. However, in view of the fact that, as pointed out above, the interest of a creditor or heir may be subject to garnishment after the court order of distribution, it is doubtful that the interest would be available for general creditors or that any dividends subsequent to the court order would go to the estate.

In any event, Section 2032 does not deal with the incidence of taxation but merely with the time at which valuation is to take place. In such a situation receipt or control of the property is not the important factor. See *Chase Nat. Bank v. United States*, 278 U.S. 327 (1929). Therefore, the fact that the regulation requires that the value is determined on a date

⁷Although the order for partial distribution was requested from the court under Oregon Revised Statutes (Chapters Replaced 1961-1962), Sec. 117.350, which authorizes such distribution, the court order itself "authorized and directed" (R. 29) the distribution, and, under Oregon Revised Statutes (Chapters Replaced 1963-1964), Sec. 5.040, the court does have the authority to "direct" the payment of debts and legacies.

prior to the one on which the beneficiary receives actual possession does not mean that the regulation is invalid.

It is also important to note that this is apparently the first time in almost 30 years that anyone has challenged the validity of the particular regulation involved. If, as taxpayer contends, it is so clear that distribution means physical distribution, and the regulation is clearly unwarranted, then why has no one brought this to the attention of the courts before this? We submit that it is because it is quite logical to define the word "distribution" as used in Section 2032 and furthermore the regulation in question gives the word a reasonable definition. The mere fact that the regulation happened to work a slight disadvantage to taxpayer in this situation is certainly not a "weighty reason" for declaring the regulation invalid.

CONCLUSION

For the foregoing reasons, the decision of the District Court is correct and the judgment should be affirmed.

Respectfully submitted,

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MARCH, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ^{2nd}23rd day of ^{MARCH}February, 1966.

SIDNEY I. LEZAK,
United States Attorney

